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ABSTRACT

Information on three categories of deferred gifts, deferred gift valuation, and reporting on deferred gifts are presented, based on the NACUBO publication entitled "Management Reporting Standards for Educational Institutions: Fund Raising and Related Activities." In addition, a summary is presented of the results of a 1982 informal survey of 29 colleges and universities concerning the valuation methods. Deferred gifts are divided into three major categories: pooled income funds, charitable remainder trusts (both unitrusts and annuity trusts), and charitable gift annuities. There are three prevailing alternatives for determining the value of gifts received in the form of charitable remainder trusts, pooled income funds, and gift annuities that are referred to as tax method, net realizable value, and fair market value. Of 29 colleges and universities responding to the informal questionnaire, 20 indicated that they preferred reporting deferred gifts at fair market value as opposed to net realizable value. According to "College and University Business Administration," accounting for annuity funds requires the recording of assets at cost or at fair market value at the date of receipt. (SW)

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Deferred Gift Reporting

by PETER L. MUNGER and JAMES F. RIDENOUR

How do you count matching gifts?

How do you report deferred gifts?

How do you value gifts of stock?

These and many other important questions are answered in the NACUBO *Administrative Service* supplement, "Management Reporting Standards for Educational Institutions: Fund Raising and Related Activities," the culmination of a project undertaken jointly by NACUBO and the Council for Advancement and Support of Education (CASE) and funded by a grant from the Exxon Education Foundation.

In addition to establishing a common dialogue between business officers and development officers, the document provides information for:

- O compiling results of fund-raising programs,
- O facilitating comparison of fund-raising results with similar, cooperating institutions, and
- O monitoring the relationship between fund-raising efforts and related program activities.

The management reporting standards are not intended to replace the accounting and reporting standards contained in *College and University Business Administration* or in the AICPA guide, *Audits of Colleges and Universities*, as amended. In fact, the document contains a chart for reconciling gift amounts to the college or university's financial statement.

Although there were many issues throughout the development of standards for reporting fund raising and related activities, the valuation of deferred gifts—charitable remainder trusts, pooled income funds, and gift annuities—was among the most debated issues. The remainder of this article will explain the definition contained in the document, highlight variations in current practice, and report the results of a recent informal survey.

Background

Deferred gifts are divided into three major categories: pooled income funds, charitable remainder trusts (both unitrusts and annuity trusts), and charitable gift annuities. Pooled income funds are like mutual funds, with donors receiving income based on equivalent shares in the pool.

Charitable remainder trusts (both unitrusts and annuity trusts) are held by a trustee (which can be the institution), with the institution being the residual beneficiary of the assets. Charitable remainder annuity trusts pay a fixed amount each year, as determined by the donor and the institution (at least 5 percent of original gift assets).

Charitable gift annuities are created when the donor actually transfers the assets to the institution, using the tables from the Committee on Gift Annuities, for a lifetime fixed-dollar annuity.

Deferred Gift Valuation

There are three prevailing alternatives—and perhaps more—for determining the value of gifts received in the form of charitable remainder trusts, pooled income funds, and gift annuities that may be referred to as "tax method," "net realizable value," and "fair market value."

At an early date in the project, it was determined that "tax legislation and Internal Revenue Service formulas for calculating the amount of deduction allowed on various gifts should be avoided." The wisdom of this decision appears to be supported by the recent flurry of Tax Court rulings that have challenged the current formulas and interest rates published by the Committee on Gift Annuities as being too conservative.

An earlier exposure draft of the reporting standards mailed to NACUBO and CASE member institutions in 1981 suggested that "net realizable value" be used for reporting deferred gifts. Later it was determined that the term was ambiguous. The most recent exposure draft reverted to use of "fair market value"—since most institutions are using it anyway—unless there is reason to believe that a significant portion of the principal may be used to meet a payout obligation to the donor.

Long-Time Confusion

The Council for Financial Aid to Education (CFAE) reports long-time confusion on how to report deferred gifts. Each year it receives more questions on this subject than on any other. Anne F. Decker, assistant vice president for CFAE, remembers one institution that listed all of its deferred gifts cumulatively each year, rather than the new gifts for the year

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in question. Another institution listed each gift twice, once in the year in which it was received and once in the year in which the donor died.

The definition in the current document reads:

> *"Charitable remainder trusts, pooled income funds, and gift annuities:* Gifts made to establish charitable remainder trusts, contributions to pooled income funds, and gift annuities should generally be credited at fair market value, i.e., the full amount of the assets given. In those instances where it is anticipated that a portion of the principal will be returned to the beneficiary in order to meet a payout obligation, the gift should be credited at its net realizable value, i.e., the remainder interest, as calculated by the institution for financial statement purposes. . . .
>
> *"Example:* A donor establishes a unitrust with an institution by transferring stock with current market value of $150,000 at the time delivered. The institution should include $150,000 in its gift totals.
>
> *"Note:* Provision has been made in Part III: *Other Program Data* for citing the full amount (market value) and the net realizable value (remainder interest) of the assets given to establish charitable remainder trusts, to add to pooled income funds, or to purchase gift annuities."

The standard is intended to convey that when the periodic payment to the donor is no greater than the estimated income that can be earned on the assets received, then the fair market value of the gift at date of receipt should be reported. If, however, the donor is guaranteed an annuity amount that may at some time before death require use of principal in order to satisfy the agreement, then the present value of such liability should be calculated and offset against the value of the assets received.

The definition in the current draft came about in part to provide a simpler and more straightforward method of valuation and one that in fact was consistent with practice in most colleges and universities.

Survey Results

An informal survey was sent to 45 colleges and universities in early June 1982 to confirm what most believed to be the predominant valuation method. Of the 29 institutions responding to the questionnaire, 20 indicated that they preferred reporting deferred gifts at fair market value as opposed to net realizable value. Some of the reasons given for using the fair market value included:

- O Straightforward and easy for all to understand.
- O Avoids annual reevaluation.
- O Other long-term assets are not stated at present value.
- O Charitable remainder computation for tax deductions is based on low interest assumptions.
- O Net realizable value unnecessarily complicated.
- O Donors consider a gift made of the full annuity amount.
- O Annuity interest rate normally lower than rate on earnings.

When asked how the institution would evaluate a $100,000 gift given by a 65-year-old man toward an 8 percent straight unitrust to be paid quarterly, 19 out of the 29 institutions indicated that they would value the gift at $100,000. The remaining ten institutions calculated the amount based on IRS tables, i.e., the charitable deduction. However, it is noteworthy that only two out of the ten calculated the same amount. None of the institutions attempted to determine the present value of the annuity liability and offset that against the fair value of assets received, which is the method described in *College and University Business Administration* for determining the "fund addition" at the time of the deferred gift.

Persons receiving the questionnaire were also asked whether there were any minimum amounts required for deferred gifts. Seven indicated that they did not have any established minimum. Those with minimums indicated amounts varying from a high of $50,000 to a low of $1,000. Nine had minimum ages for life beneficiaries starting at age 40 and increasing to age 60.

Accounting and Auditing Standards

College and University Business Administration contains a section on accounting for annuity and life income funds. It states that ". . . accounting for annuity funds requires the recording of assets at cost or at *fair market value* [emphasis added] at the date of receipt. The liabilities should be stated at the present value of the aggregate liability or annuity payable, based on acceptable life expectancy tables. There may be a fund balance or deficit, depending on the relationship between assets and liabilities. . . . Investment income and gains are credited and annuity payments and investment losses charged against the liabilities. Periodically, an adjustment is made between the liabilities and the fund balances because of recomputation of the liabilities, based on the revised life expectancies and anticipated return on investments." It should be noted that these procedures also provide for valuation of the assets received at *fair market value*. Only the fund balance is reduced by the present value of the annuity liability.

Investment Objectives

Investment officers generally take a different view of gift valuation. They often seek assets that will grow in market value in order to offset the impact of inflation. Accordingly, many endowment programs have low spending rates, e.g., 4 percent, in order to limit the income demand and free the portfolio manager to invest in stocks and other securities that will appreciate. The investment objective becomes a total return in excess of inflation and the spending rate. Using this objective, even though an institution could easily earn 8 percent to satisfy an annuity commitment, such a requirement might subject the principal to erosion by inflation.

The Future

The foreword of the exposure draft states: "It must be recognized that these management reporting standards and report formats are evolutionary in nature and that changes are not only inevitable but also desirable." No doubt the guidelines, including the valuation of deferred gifts, will continue to be subject to scrutiny and discussion. Perhaps someday the business world will develop a more precise way for measuring the "value" of deferred gifts, but for now, fair market value appears to be the only measurement that can be applied consistently. ♦

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